

August 26, 2008

Advisory Committee on the Auditing Profession  
Office of Financial Institutions Policy  
Room 1418  
United States Department of the Treasury  
1500 Pennsylvania Avenue, N.W.  
Washington, D.C. 20220

**Re: PricewaterhouseCoopers' Comments on the Second Draft Report of the  
Advisory Committee on the Auditing Profession**

Dear Committee Members:

PricewaterhouseCoopers appreciates the opportunity to comment on the Second Draft Report issued by the Department of the Treasury's Advisory Committee on the Auditing Profession (the Committee) on July 22, 2008.

The Second Draft Report retains much of the analysis and many of the recommendations in the initial Draft Report. As such, we believe our previous testimony on December 3, 2007 and June 3, 2008, as well as our previous comment letter of June 30, 2008 provided specific recommendations, suggestions, and input that remain relevant to the current draft report and addendum. We hope the Committee will continue to take those comments into account. Our additional comments, provided herein, will focus on two issues: transparency and litigation reform.

**Transparency and Audit Quality**

As indicated in our earlier comment letter, we believe it makes eminent good sense for the PCAOB and the SEC to evaluate whether audit reports convey as much information as the capital markets would find useful, especially as the U.S. evolves toward a more principles-based, globally uniform accounting system. Such information might well go beyond what is provided under the current "pass/fail" model for audit reports. Obviously, and as the Addendum acknowledges, this evaluation should be undertaken with the participation of relevant stakeholders, such as public companies, investors, public company auditors, and other users of financial statements.

Moreover, as PwC's U.S. General Counsel, Charles Gerdtz, indicated in his responses to the Committee's written questions, PwC agrees with the Committee that greater transparency in metrics of audit quality would benefit the capital markets. Thus, PwC strongly supports what is now Recommendation 3 in Chapter VI of the Second Draft

Report. Providing market participants with more information on indicia of audit firm quality would allow them to make better choices by facilitating comparability and fostering competition on quality among audit firms. Just as public companies seek to attract investors through strong financial results, audit firms should seek to distinguish themselves on the basis of measures of audit quality. For public registrants, financial disclosure is the principal means by which their owners —public shareholders— understand and monitor the companies' performance. Because the public interest in audit firms derive from those firms' public mandate to perform effective audits, the equivalent public disclosure would involve metrics by which the capital markets, and particularly audit committees, could confirm that audit firms were providing high-quality audits

As indicated in our earlier comment letter, however, PwC continues to view aspects of what is now Recommendation 7 in the Second Draft Report's Chapter V as not furthering the twin goals of audit quality and profession-wide sustainability.

**Recommendation 7: Urge the PCAOB to require that, beginning in 2010, larger auditing firms produce a public annual report incorporating (a) information required by the EU's Eighth Directive, Article 40 Transparency Report deemed appropriate by the PCAOB, and (b) such key indicators of audit quality and effectiveness as determined by the PCAOB in accordance with Recommendation 3 in Chapter VI of this Report. Further, encourage the PCAOB to require that, beginning in 2011, the larger auditing firms file with the PCAOB on a confidential basis audited financial statements.**

As we noted in our earlier letter, we believe the PCAOB has a critical role to play in promoting audit quality, and thereby enhancing the reliability of publicly reported financial information. Through the PCAOB's oversight authority and annual inspection process, public company auditing firms now provide significantly increased transparency into their internal operations. This increased transparency and oversight provide an important safeguard to audit quality and independence.

As Mr. Nally testified before the Committee, PwC supports the development and reporting of objective measures of audit quality.<sup>1</sup> While we recognize that such reporting would impose burdens on firms, and that such burdens may lead the Committee to propose a "larger firm" threshold for such reports, we believe such information will be most useful when they are adopted and reported by the largest number of firms possible.

Moreover, as Mr. Gerdtz stated in his testimony, PwC agrees with the Committee that the EU's Eighth Directive, Article 40 Transparency Report, if modified to fit the unique aspects of the U.S. legal and regulatory system, would provide a model for a transparency regime that regulators should consider.<sup>2</sup>

As indicated in our earlier comment letter and in Mr. Gerdtz's testimony, PwC believes that the final portion of Recommendation 7, which would require large audit firms to

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<sup>1</sup> Nally Written Submission at 6.

<sup>2</sup> Gerdtz Written Submission at 11.

prepare and submit to the PCAOB audited financial statements, may impose a significant burden on firms without any commensurate improvement in audit quality.

As Mr. Gerdts and Kathryn Oberly, General Counsel of Ernst & Young, both explained in their testimony, like most partnerships that are not SEC registrants, neither PwC nor Ernst & Young currently prepares audited financial statements for their own partners.<sup>3</sup> Requiring large audit firms to do so should only be based on a compelling connection to enhanced audit quality. We do not believe such a connection has been drawn. As Mr. Gerdts explained in his testimony “for public registrants, financial disclosure is essential to let their owners—public shareholders—understand and monitor how the companies are performing. For audit firms, the equivalent disclosure would involve the metrics that provide the government and the capital markets confidence that audit firms are providing trustworthy, quality audits. Disclosure of firm financial statements would not meet that objective.”<sup>4</sup>

PwC believes that if audit firms are to be required to prepare audited financial statements, the statements should be submitted in confidence to the PCAOB, rather than disclosed to the general public.

### **Litigation Reform and Sustainability**

As indicated in our earlier letter, PwC strongly believes that liability reform is necessary to maintain the viability of the auditing profession, and is critical to U.S. capital markets competitiveness. As Mr. Gerdts noted in his testimony, “[v]irtually every study of the accounting profession in recent years has recognized that the major firms performing public company audits face the very substantial risk of a catastrophic event ... and a significant component of [that risk] is the current U.S. litigation regime under which auditing firms operate.”<sup>5</sup> Moreover, this exposure not only threatens the viability of the largest firms, it also “deters small and mid-sized firms from expanding their public company audit business or entering the market in the first place.”<sup>6</sup> By limiting audit firm choice, liability risk actually undermines competition and therefore audit quality.

The Addendum stated that the Committee was “considering whether it should recommend that Congress provide federal courts with exclusive jurisdiction over some categories of claims, which presently may be brought in state courts against auditors, when such claims are related to audits of public company statements.” If Congress were to undertake such an effort, the Addendum noted, it should “develop a uniform standard of care with appropriate and necessary levels of investor protection.”<sup>7</sup>

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<sup>3</sup> Cite June 3, 2008 Transcript.

<sup>4</sup> Written Submission of Charles W. Gerdts, III, General Counsel, PricewaterhouseCoopers LLP, 12 June 3, 2008.

<sup>5</sup> Gerdts Written Submission at 6.

<sup>6</sup> Gerdts Written Submission at 7.

<sup>7</sup> Addendum to VI at 8.

We do not see these statements in the Second Draft Report, but we understand, based on remarks at the Committee's July 22, 2008, open meeting, that it is still considering how to address concerns about catastrophic liability risk. We welcome the Committee's acknowledgement in the Second Draft Report that "these risks are real."<sup>8</sup>

Indeed, as indicated in Mr. Gerdt's responses to written questions, aggregate data submitted to the Committee by the six largest audit firms through the Center for Audit Quality demonstrate the threat posed to the audit profession and audit firms by catastrophic risk. Moreover, as our earlier letter emphasized, we believe that the Committee should take a broad view of the problem and not necessarily focus narrowly on fixes for auditing firms. As Mr. Nally observed in his testimony, much of the litigation risk for accounting firms stems from the firms' reoccurring role as defendants in securities class action litigation."<sup>9</sup> A recommendation regarding jurisdiction and a uniform standard of care therefore should address "whether the U.S. securities litigation system efficiently accomplishes the goals of compensation and deterrence."<sup>10</sup>

In conclusion, we appreciate the Committee members' time and service, and we thank the Committee for its consideration of our comments and suggestions on the Second Draft Report.

Sincerely,



PricewaterhouseCoopers, LLP

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<sup>8</sup> Second Draft Report at VI:9.

<sup>9</sup> Nally Written Submission at 3.

<sup>10</sup> *Id.*